

estimony



STATEMENT OF
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FOR AUDITING
DEPARTMENT OF DEFENSE
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SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION AND TECHNOLOGY,
HOUSE COMMITTEE ON GOVERNMENT REFORM
ON
DEFENSE ACQUISITION MANAGEMENT

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Mr. Chairman and Members of the Committee:

I appreciate the opportunity to testify before you today on the always challenging and important subject of Defense acquisition management. As you are well aware, the cost, quality and need for military equipment and supplies have been contentious issues in this country for over 200 years. In FY 1999, the Department of Defense bought about \$140 billion in goods and services, in 14.8 million purchasing actions. The complexity, variety, scale and frequent instability of Defense acquisition programs pose particularly daunting management challenges. Today, those challenges are centered more than ever on the need to strike difficult balances, such as:

- maintaining technological superiority, but not over designing weapon and information systems so that they are unaffordable;
- expediting the development and production of systems so that our forces have the best available equipment, without rushing untested systems prematurely into production and use;

- achieving standardization to reduce costs and logistics problems, without stifling innovation and short changing genuinely unique requirements;
- purchasing supplies quickly to ensure rapid response to the needs of the operating units, without paying exorbitant prices or over buying because of poor analysis of requirements and prices;
- ensuring high quality for all material on which our military forces depend, without over prescribing details related to design, content and production methods;
- improving Defense acquisition results by learning from best practices in the commercial sector, without trying to adopt practices that may not be appropriate or readily adaptable to the public sector;
- Reducing the red tape and streamlining overly bureaucratic processes without weakening essential management controls and de-emphasizing due diligence in handling public resources;

- striving for rapid and far-reaching acquisition process improvements, without overwhelming the workforce with changes that are not accompanied by timely and effective training; and
- attempting to minimize the cost of Defense support functions, without reducing the workforce past the point where it can effectively handle its workload.

The focus for concerns regarding Defense acquisition shifts periodically. During the 1970's, the principal problems were cost overruns on major weapon system contracts and huge contractor claims. In the 1980's there were major issues concerning the adequacy of testing, contractor fraud, overpriced spare parts and corruption involving Navy procurement officials (the Ill Wind scandal). In the 1990's there were the A-12 Intruder program failure; increasing concerns about the inordinate time needed to field new systems; growing dissatisfaction with perceived over regulation and red tape; concerns over the affordability of systems with high per unit costs; imbalances between spending for investments, overhead support and operations; and contraction of the Defense industrial base.

Acquisition Reform. The Department of Defense has been seeking acquisition process improvements almost continuously for at least 20 years. Likewise, Congress legislates changes in both program content and procurement practices almost annually. However, there has been intensified interest and effort during the past several years. The Department has initiated an unprecedented number of major improvement initiatives across the spectrum of DoD activities, including at least 40 significant acquisition reform initiatives. The Congress has passed very important reform legislation, including the Federal Acquisition Streamlining Act of 1994 and the Clinger/Cohen Act of 1996. The Department has made notable progress in acquisition reform and also set several commendable goals. Examples include:

- de-emphasizing overly detailed military specifications and standards;
- using credit cards for nearly 9 million small purchases in FY 1999;
- pushing for public and private sector implementation of public key infrastructure technology to enable secure electronic commerce;

- replacing multiple, inconsistent, government-unique requirements imposed on contractors holding more than one Defense contract with common, best, facility-wide processes; and
- establishing aggressive weapon system unit cost and total ownership cost targets, which are 20 to 50 percent below historical norms and will be challenging to meet.

I assume that other witnesses today will discuss additional initiatives.

Inspector General Role in Acquisition Reform. Since its establishment in 1982, the Office of the Inspector General, DoD, has issued hundreds of audit reports identifying problems in Defense acquisition programs and opportunities for improving efficiency and effectiveness. In addition, the principal focus of the Defense Criminal Investigative Service, the criminal investigative component of the Office of the Inspector General, DoD, always has been procurement fraud, in its various forms. Based on the many risks, vulnerabilities and problems identified by this audit and investigative effort, the Office of the Inspector General, DoD, has been in the forefront of those calling for improved management across the spectrum of Defense

acquisition program activities, from initial requirements determination through purchasing and delivery of goods and services.

Most acquisition audits and investigations provide insight into how well individual programs and contracts are managed. Many of them also provide independent feedback on how well the Department's overall acquisition policies and applicable laws or regulations are being implemented, and whether they are having the intended effect. Audits are a particularly useful tool for verifying that reported performance information is accurate and previously identified problems have been corrected.

Unfortunately, in recent years our oversight of Defense acquisition has been severely constrained by resource shortfalls and conflicting priorities. In testimony last month before the House Budget Committee, the Deputy IG expressed concern that audit coverage has been inadequate in nearly all Defense management sectors that we and the General Accounting Office have identified as high risk areas.

The DoD needs a broad, systematic program of comprehensive audits of acquisition programs, but does not have one. Currently, less than ten of the several hundred weapon system

projects are being comprehensively reviewed by DoD internal auditors each year. The same holds true for the 79 major information system development and modification projects and the hundreds of smaller projects in the information technology area. The Department spent \$51.8 billion for consultants and other support services in FY 1999, yet there have been only a few recent internal audits on management controls over contracting for services. Finally, there is limited independent information available on the progress of the 40 reform initiatives and the need for other initiatives.

The heavy workload created by the successful DoD Year 2000 conversion effort, which my office supported with over 180 audits, is now behind us and we are trying to redress the imbalances in coverage caused by that extraordinary effort. There continue to be conflicting priorities for audits, such as information security, readiness issues and financial reporting. Last year, the DoD decided not to proceed with most of the planned continued reduction of the IG budget, which had already been reduced by 26 percent since 1995. Unfortunately, the appropriations committees cut our FY 2000 request, which hampers our ability to do more in vital areas like acquisition. We hope to be able to better explain our resource situation this year

and to achieve congressional support of our FY 2001 budget request.

In addition to audit and investigative efforts, the IG role in acquisition management improvement includes reviewing all proposed legislative and regulatory changes. The Department has been generally responsive to our advice on such matters and congressional committees also request our views on acquisition legislation issues on a routine basis.

To study acquisition issues, identify opportunities for reform, suggest specific actions, plan implementation strategies or monitor progress, the Department often forms cross-organizational teams and task forces. Assisting those efforts is a high priority for us. Senior audit personnel currently are participating as official team members or advisors for 16 acquisition or logistics reform teams. They include the Acquisition Reform Senior Steering Group, Acquisition Deskbook Working Group, Joint Contracting Pilot Program, and a team working on long term pricing arrangements for spare parts.

Special Emphasis Areas. There are a myriad of challenges and potential issues inherent in the processes for deciding what force structure is needed to implement the national security

strategy; what weapon systems are needed to assure success in combat; what supporting information systems, supplies and other logistical support are needed; what the required goods and services should cost; what is affordable; what acquisition strategy would be best; what prices are reasonable; and so forth. Today I would like to focus on three of those many sets of issues, using recent audit results from the reports that are listed in the attachment to this statement. Those three areas are contracting for services, spare parts pricing and acquisition workforce reductions.

Contracting for Services. Issues related to Defense weaponry and other equipment attract the most oversight emphasis and publicity, yet the annual DoD expenditures for contractor services constitute a huge acquisition program in their own right. From FY 1992 through FY 1999, DoD procurement of services increased from \$39.9 billion to \$51.8 billion annually. The largest sub-category of contracts for services was for professional, administrative, and management support services, valued at \$10.3 billion. Spending in this sub-category increased by 54 percent between 1992 and 1999. It probably will continue to grow as outsourcing initiatives expand.

Deliverables from contracts for services often are not as tangible as hardware, such as a missile or even a set of tires. Quantifiable information on requirements, performance and costs frequently is harder to develop, and overworked contracting personnel are more likely to give priority attention to equipment procurements than to mundane contracting actions for consulting services or information systems support. Also, except for travel and transportation services, the increased efficiencies derived from e-commerce pertain much more to goods than to services. We believe that, because of these factors, DoD managers and contracting personnel were not putting sufficient priority during the 1990's on this sector of Defense acquisition, which likewise was virtually ignored for the first few years of recent acquisition reform efforts. Consequently, we think the risk of waste in this area is higher than has been commonly realized.

The awareness of the need for more emphasis on services contracts has been growing over the past year, in part because of two major audits, whose results I would like to summarize for you.

Multiple Award Task Order Contracts.

The Federal Acquisition Streamlining Act authorized agency heads to enter into multiple award delivery and task order contracts for procuring goods and services. Multiple award contracts occur when two or more contracts are awarded from one solicitation. Generally these contracts have broad scopes and dozens of subsequent task orders are awarded by the Government over the life of the contract. The Act established a general preference for using multiple awards and mandates their use for advisory and assistance services contracts exceeding \$10 million and 3 years duration. The Act also stipulates that contractors on a multiple award arrangement are to be provided a "fair opportunity to be considered" for individual task and delivery orders over \$2,500.

Multiple award contracts are an excellent tool for avoiding duplicative solicitations and speeding up the contracting process. Their advantages are degraded, however, if the individual task and delivery orders are inappropriately sole-sourced or poorly priced.

In April 1999, we reported the results of an audit of 156 orders, valued at \$143.7 million and placed on 12 multiple award

contracts between 1995 and 1998. We found few problems with delivery orders for goods, but significant problems with task orders for services. Specifically:

- Contracting officers awarded task orders without regard to price, even though price also was not a substantial factor in the selection of vendors for the initial multiple award contract. As a result, higher-priced contractors were awarded 36 of 58 task orders that were competed. We identified \$3 million in additional costs resulting from awarding orders to contractors with higher-priced bids.
- Contracting officers directed work and issued orders on a sole-source basis for 66 task orders, valued at \$47.2 million, without providing the other contractors a fair opportunity to be considered. Only 8 of the 66 orders, valued at \$8.8 million, had valid justification for sole-source award. As a result, DoD almost certainly paid higher prices than would have been the case if competition had been sought.

These problems were caused by a variety of factors, including difficulty in establishing pricing on the multiple award contracts at the time of award, because requirements for the

number and scope of subsequent task orders were not well understood. Contractors also were not sure of the amount of work they would receive, making it hard to forecast costs. Regarding the failure to compete task orders, I believe the causes were somewhat vague regulations, pressure to make task order awards rapidly, and perhaps excessive workload in some contracting offices.

In response to the audit findings, the Director for Defense Procurement has been gathering information from the Military Departments on the need to establish a competition goal for task orders on multiple award contracts--we had suggested that a goal of 90 percent would be advisable. The Director also issued a memorandum in April 1999 calling the audit results to the attention of senior acquisition officials. The Congress took action by mandating in Section 804 of the National Defense Authorization Act for FY 2000 that the Federal Acquisition Regulation be revised to improve guidance on the appropriate use of task order and delivery order contracts.

Other Problem Indicators. In light of the problems found by the audit on multiple award task order contracts and various other, more narrowly scoped audits, we undertook a comprehensive audit last year to look at services contracts. We reviewed

105 Army, Navy and Air Force contracting actions, valued at \$6.7 billion, for a wide range of professional, administrative and management support services amounting to about 104 million labor hours, or 50,230 staff years.

We were startled by the audit results, because we found problems with every one of the 105 actions. In nearly 10 years of managing the audit office of the IG, DoD, I do not ever recall finding problems on every item in that large a sample of transactions, programs or data. The specific problems included:

- Failure to use prior history to define requirements (58 actions);
- Poor Government cost estimates (81 actions);
- Cursory technical reviews (60 actions);
- Inadequate competition (63 actions);
- Failure to award multiple award contracts (7 actions);
- Incomplete price negotiation memorandums (71 actions);

- Inadequate contract surveillance (56 actions);

- Lack of cost controls (21 actions);

It was impossible to quantify the monetary impact of these deficiencies, but clearly waste was occurring. For example, sole-source cost-type contracts that placed a higher risk on the Government continued without question for the same services for inordinate lengths of time--39 years in one extreme case--and pricing was questionable. We also observed that there were no performance measures in use to judge the efficiency and effectiveness of the services rendered.

We made numerous recommendations to management to address these problems, stressing the paramount need for more effective training. Many cost-reimbursable contracts for repetitive tasks should be converted to more economical fixed price contracts. We also endorsed establishing centers of excellence, which in this case would be specialized contracting organizations or cadre, as a means of developing in-depth expertise on the services markets and on services contracting techniques. We understand that this concept has proven highly beneficial for private sector businesses that purchase large volumes and varieties of contractor services. The Department has not yet

informed us of its position on all of our recommendations, but the partial responses to date have been positive.

In fact, recently we have noted a welcome upswing in interest and activity regarding contracting for services and we are assisting in efforts such as developing a Performance Based Service Acquisition Training Class. We agree with the Federal Procurement Executives Council that performance based acquisition strategies should be heavily emphasized when contracting for services and we support the putative goal of making half of services contracts performance based by 2005. We welcome DoD plans for putting information such as a guide for performance based service acquisitions on the web and establishing a baseline and measures for tracking progress on expanding the performance based approach.

Continuing Spare Parts Pricing Issues. In early 1998, we began issuing a series of audit reports on prices paid for aviation spare parts and equipment. As you may recall from congressional hearings at the time and intermittent publicity since, we found that prices paid under new, commercial type contracting arrangements were considerably higher than was the case when the same items were procured previously under "traditional" Defense contracts or ordering agreements. In one case, DoD paid

modestly discounted, but still excessive, contractor catalog prices that were \$4.5 million (280 percent) higher than fair and reasonable prices for \$6.1 million of commercial items from one supplier.

Although the Department has been generally responsive to the problems that we have identified on individual contracts, new examples continue to surface as we do additional audits. We have issued 5 more reports on spare parts in the last two years. One report provided good news and the other four described problems. Most recently, in a pair of reports issued a few days ago, we discussed pricing in a prototype contract for supply support from what the DoD refers to as a virtual prime vendor. Under this concept, one vendor anticipates DoD needs for a specified list of commodities and assumes responsibility for having inventory on hand to meet those needs, using a range of modern commercial business practices and techniques. Theoretically, considerable savings should result from shifting the burden of carrying inventory to the vendor.

As with many prototypes, the terms of this particular contract needed some adjustments. The audit indicated that DoD was paying 38 percent more than necessary for a variety of aviation components and spares. The most egregious example was a

propeller blade heater for C-130 and P-3 aircraft. We calculated that the \$1.4 million paid in 1998 for blade heaters was from 124 to 148 percent more than fair and reasonable prices. Although management did not agree with many of our exact calculations, the Department fully agreed with our recommendation to use an entirely different contracting approach, namely, a long-term strategic supplier alliance. In fact, initial meetings with the contractor to explore that approach were held during the audit.

There are a variety of problems to be addressed in spare parts procurement. First, the Government must learn to be a smarter buyer in terms of pooling its purchases to maximize its market leverage, enable in-depth market research by specialists and use economic order quantity approaches where feasible. Second, it needs to do everything possible to maximize competition and avoid sole-source situations. Virtually all of the pricing problems identified by our audits arose on sole-source contracts. Third, it needs to consider root causes of poor purchasing decisions: under staffing in DoD procurement offices, unreliable inventory data and inadequate training. Fourth, it needs to pursue long term pricing arrangements with key suppliers, with mutual incentives for price reduction. Fifth, it should use the tools already made available by the

Congress--including the ability under the Truth in Negotiations Act to obtain certified contractor cost data--to ensure fair pricing in sole-source procurements. For commercial items, to which the Truth in Negotiations Act does not apply, contracting officers can still negotiate good prices on the basis of uncertified cost data. Some DoD acquisition officials discourage them from doing so, but offer no practical alternatives for situations where no competitive market forces exist to drive down prices.

Acquisition Workforce Issues. Having made previous references to problems caused by lack of contracting workforce capacity and training, I would like to call your attention to our Report on the DoD Acquisition Workforce Reduction Trends and Impacts, dated February 29, 2000.

The DoD reduced its acquisition workforce from 460,516 in September 1991 to 230,556 in September 1999 and further cuts are likely. If workload had been reduced proportionally, eliminating half of the acquisition positions could be regarded as a positive achievement. Unfortunately, this has not been the case. From FY 1990 through FY 1999, the value of DoD procurement actions decreased from \$144.7 billion to \$139.8 billion, about 3 percent. The number of procurement

actions increased from 13.2 million to 14.8 million, about 12 percent. The greatest amount of work for acquisition personnel occurs on contracting actions over \$100,000, and the annual number of those actions increased from 97,948 to 125,692, about 28 percent, from FY 1990 to FY 1999.

We surveyed 14 of the 21 major acquisition organizations and found this growing imbalance between resources and workload is a major concern. Acquisition personnel told us that the adverse consequences include:

- skill imbalances (9 organizations), and
- insufficient staff to manage requirements efficiently (9 organizations),
- increased program costs resulting from contracting for technical support versus using in-house technical support (7 organizations),
- personnel retention difficulty (6 organizations),
- reduced scrutiny and timeliness in reviewing acquisition actions (4 organizations),

- increased backlog in closing out completed contracts
(3 organizations),
- lost opportunities to develop cost savings initiatives
(2 organizations).

I believe that this impact list is conservative and, if further downsizing occurs, these staffing management problems and performance shortfalls can only get worse.

Likewise, there is cause for serious concern in the likelihood of the DoD acquisition workforce losing about 55,000 experienced personnel through attrition by FY 2005 and in the overall disconnects between workload forecasts, performance measures, productivity indicators, and plans for workforce sizing and training.

In a general sense, DoD acquisition workforce reductions are part of the overall downsizing of the Federal and Defense workforce. However, Congress has singled out the DoD acquisition population for separate downsizing emphasis, while allowing the Secretary of Defense considerable latitude in implementing reductions. We hope that our report will

assist both the Congress and the Department to take stock of the long-term human capital requirements in this crucial area. The Department's response to the report was positive and there appears to be growing awareness of the serious risks related to the Defense acquisition staffing outlook.

A reasonably sized, well-trained and highly motivated workforce is by far our best safeguard against inefficiency and waste.

Conclusion. The Office of the Inspector General, DoD, continues to be a strong supporter of acquisition reform. I appreciate your interest in our reports and views on these challenging matters. This concludes my statement.

Acquisition Audit Reports
By Inspector General, DoD
Mentioned in this Testimony

99-026, Commercial Spare Parts Purchased on a Corporate Contract, October 30, 1998. The DoD paid a 54.5 percent premium, \$3.2 million, on the audited contract for aviation spares in fiscal years 1996 and 1997, but did not use the services offered at the higher prices.

99-116, DoD Use of Multiple Award Task Order Contracts (4/2/99). The audit was requested by Senator Carl Levin. Task orders were awarded without sufficient consideration to price on 36 of 58 audited task orders. Only 8 of 66 audited sole-source task orders had valid sole-source justifications.

99-217, Sole-Source Commercial Spare Parts Procured on a Requirements Type Contract (7/21/99). A cost-based requirements contract for aviation spares was appropriately priced.

99-218, Sole-Source Noncommercial Spare Parts Orders on a Basic Ordering Agreement (7/21/99). The DoD paid \$4.9 million (18 percent) more than fair and reasonable prices for \$32.2 million of aviation spares on a basic ordering agreement during fiscal years 1996 through 1998.

00-088, DoD Acquisition Workforce Reduction Trends and Impacts (2/29/00). The Department needs to reconsider the appropriate size and skills mix of the acquisition workforce, which has been cut in half without significant workload reduction and faces future skills shortages.

00-098, Spare Parts and Logistics Support Procured on a Virtual Prime Vendor Contract (3/8/00). A long term alliance arrangement would be preferable to the contractual terms under which overpriced aviation spares were purchased in 1997 and 1998. (Report currently available only in a For Official Use Only version.)

00-099, Procurement of the Blade Heaters for the C-130 and P-3 Aircraft (3/8/00). This report discusses one of the overpriced spare parts procured under the contract that is evaluated in Report No. 00-098. (Report currently available only in a For Official Use Only version.)

00-100, Award and Administration of Contracts for Professional, Administrative and Management Support Services (3/10/00). The Military Departments needed to put more emphasis on all aspects of procurement planning, contracting and contract administration for services.